



JOHN CHIANG
California State Controller

March 2, 2011

The Honorable Jerry Brown
Governor of California
State Capitol Building
Sacramento, CA 95814

The Honorable Darrell Steinberg
President Pro Tempore
State Capitol, Room 205
Sacramento, CA 95814

The Honorable Robert D. Dutton
Senate Republican Leader
State Capitol, Room 305
Sacramento, CA 95814

The Honorable John A. Pérez
Speaker of the Assembly
State Capitol, Room 219
Sacramento, CA 95814

The Honorable Connie Conway
Assembly Republican Leader
State Capitol, Room 3104
Sacramento, CA 95814

Dear Governor and Legislative Leaders:

As State Controller, it is my responsibility to keep you informed of California's cash condition and the threats that can prevent the State from meeting its payment obligations in a timely manner. This letter will provide you with the State's cash outlook for the next six months based on two sets of assumptions: (a) timely enactment of the Governor's proposed January budget plan and (b) a budget stalemate through the months of July and August 2011.

My office's analyses include the loss of \$1.2 billion in revenues from the decision to not proceed with the proposed sale and lease-back of State properties contained in the 2010-11 Budget Act. The outlook is based on actual receipts and disbursements through January 31, 2011.

TIMELY ENACTMENT OF THE GOVERNOR'S JANUARY BUDGET PROPOSAL

Should the Governor's January budget plan be implemented as proposed, projections show that the State will have the ability to meet all of its payment obligations for the remainder of 2010-11, as well as into the new fiscal year beginning on July 1 (see the blue line on the enclosed chart).

Specifically, the State's cash balance is projected not to fall below \$4.8 billion at any time during the remaining months of the current fiscal year. This nearly doubles the \$2.5 billion

minimum cash balance that must be maintained in order to address the volatility in receipts, disbursements and availability of internal borrowable resources.

The outlook for July 2011 shows that the State's cash balance will drop slightly below the \$2.5 billion safety margin by approximately \$300 million during the final three days of the month. Due to the brief duration of the shortfall and its manageable size, my office in collaboration with the State Treasurer's Office and the Department of Finance can address the anticipated risks during this period.

With an enacted budget, the State will be in position to secure its perennial cash flow borrowing – in the form of garden-variety Revenue Anticipation Notes – within the first six weeks of the new fiscal year. Prior to the receipt of those funds, August projections show the State's cash flow balance remaining above safe levels for each day, except on August 1, when the State's cash balance is projected to be \$2.4 billion. Again, the duration and size of this shortfall can be addressed with the existing cash management tools available to the State.

LATE BUDGET

Should the Legislature and Governor fail to forge a timely budget agreement, the State will face another debilitating cash crisis for a fourth consecutive year and expose California's taxpayers and economic recovery to the risk of IOUs, delayed payments, and further credit rating downgrades (see the red line on the enclosed chart).

California's cash position for the remainder of the current fiscal year will reflect the loss of \$1.1 billion in current year spending reductions proposed in the Governor's January budget plan. However, even at its lowest point, the treasury's balance is not projected to fall below \$3.7 billion at any time during the remainder of this fiscal year.

This provides little comfort given that State will fall \$1.6 billion in July and \$1.2 billion in August short of having the capacity to pay its bills. Because the State cannot delay action until the moment it runs out of cash, my office may be obligated to deploy invasive cash conservation options far in advance of July 2011. The exact date of when my office will be pushed into action depends on factors including: revenue receipts and spending in the coming months, impending federal and state court decisions, federal budget actions, and how long it will take to conserve the \$4.1 billion necessary to bring the treasury's balance to the minimum safety margin by July.

THE BOTTOM LINE

As I have done before, I will use all measures available to me to avoid delaying payments (such as the \$4.7 billion in February and March of 2009) or issuing registered warrants (including the \$2.6 billion in July and August of 2009).

While considering budget issues, I urge you to keep in mind the following:

- Cash solutions need time in order to be realized. For example, reductions in payments that are scheduled for later in the year cannot help the cash shortage we face in the near term;
- Inaction compromises the ability to implement the necessary programmatic changes in time to achieve the full year benefit of 2011-12 solutions;
- The monthly cash balances displayed on the accompanying chart already include as much as \$19.6 billion in special funds that are available for internal borrowing. These are the special funds established to address issues that include preventing oil spills, stopping lead poisoning in children, and controlling air pollution. These loans cannot interfere with the operations of the special funds and must be repaid upon demand. In addition, the cash balances of these special funds can drop precipitously and without notice; and
- If I am forced to implement emergency cash management measures, I must act before the State's treasury is depleted. Depending on numerous factors, including how much cash needs to be conserved or the market conditions for borrowing, I may have to act weeks in advance of the projected depletion date.

"Defer and deny" is not a strategy for California's prosperity. For too many years, intense partisanship and the absence of consensus-building leadership have created completely avoidable crises which have only served to amplify and prolong the pain of the recent global recession. It is not that California lacks the economic fire power or Constitutional flexibility to address its problems – rather, its problems are primarily rooted in political origin. Unless we make the tough decisions necessary to stabilize the State's fiscal health, I fear that the next four years will be stained by chronic fiscal distress and regret over lost opportunities. Together, let's find a way to compromise – to get to "yes."

Sincerely,

Original signed by

JOHN CHIANG
California State Controller

Attachment

cc: The Honorable Bill Lockyer, State Treasurer
Members of the California State Legislature
Ana J. Matosantos, Director, Department of Finance
Mac Taylor, Legislative Analyst